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IFRS-Fachausschuss

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Mr Hans Hoogervorst
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Berlin, 22 January 2015

Dear Hans,

IASB Discussion Paper DP/2014/2 *Reporting the Financial Effects of Rate Regulation*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the IASB Discussion Paper DP/2014/2 *Reporting the Financial Effects of Rate Regulation* (herein referred to as 'DP'). We appreciate the opportunity to comment on the DP.

We closely follow the current discussion about an accounting standard for rate regulated activities (herein referred to as 'RRA'), in particular within the proposed narrow scope of 'defined rate regulation' limited to the financial effects of the so-called revenue requirements. We identified the effects from these true-up mechanisms as a main trigger for the debate within our constituency about misleading accounting of RRA and the presentation mismatch in financial performance over multiple periods.

However, a narrow scope by itself is not sufficient to argue for a new standard if it tends to ground on rules more than on principles. Therefore we would urge the IASB to carefully reconsider whether the high hurdles for introducing specific accounting principles for a specific type of business activities are met in the case of RRA.

Within our constituency, in most cases RRA do not cover all but only a particular type of transactions of the reporting entity or group (herein referred to as 'integrated businesses'). This is an important factor when considering the cost/benefit constraint of a proposed standard for RRA. Furthermore, we heard from our constituency about specific operational issues the IASB should consider in the context of intra-group RRA. These particularly relate to the application of the economic entity approach in a group with a vertically integrated business model. We refer to our response to Question 8 for further details.

Having said that, we would summarise our remaining comments as follows:

a) The main trigger for the current discussion about misleading accounting of RRA is the presentation mismatch of financial performance over multiple periods resulting from so-called true-up mechanisms. Although the starting point for any discussion about the desired accounting impact of RRA is the effect on the statement of profit or loss, we hold the view that the conceptual basis for the recognition of income and expense from RRA should be accounting principles for regulatory assets and liabilities.

b) We agree with the IASB in focusing on a defined type of rate regulation in order to provide a common starting point for a more targeted discussion. Regarding the proposed definition of defined rate regulation we noticed that some of the items of that definition are not necessarily triggering the accounting impact. Instead, we would suggest that the definition refer to the right or obligation to recover the revenue requirement (which might not be enforceable), in the sense that the enforceable right to receive a regulated rate for the supply of essential goods or services (usually a long-term right over a multi-year regulation period) "*ensures*" that the entity recovers no more or less than its revenue requirement.

c) Any other features that are more descriptive in nature, elaborate on the motivations or reasons for the existence of a regulatory environment, and attempt providing a very high certainty of the future recoverability of the charged rate components from true-up mechanisms should be evaluated as part of recognition or measurement principles.

d) We generally support the recognition and presentation of the effects of regulatory deferral accounts in the statement of financial position and the statement of profit or loss for a regulated entity, accompanied by specific disclosure requirements. Of the alternative accounting approaches presented in the DP, we would suggest the IASB further develop ìts thinking about specific IFRS requirements to defer/accelerate the recognition of costs and/or revenue in the context of our proposed definition. However, from a conceptual point of view, this might not be sufficient and we see some merits in having a look into the asset/liability-based approach in IFRS 15.

For more details on the technical analysis we refer to our responses to the individual questions in the Appendix of this letter.

If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr

President

Appendix – Answers to the questions of the Discussion Paper

Question 1

(a) What information about the entity's rate-regulated activities and the rate-regulatory environment do you think preparers of financial statements need to include in their financial statements or accompanying documents such as management commentary?

Please specify what information should be provided in:

(i) the statement of financial position;

(ii) the statement(s) of profit or loss and other comprehensive income;

(iii) the statement of cash flows;

(iv) the note disclosures; or

(v) the management commentary.

(b) How do you think that information would be used by investors and lenders in making investment and lending decisions?

General remarks

We have heard from our constituency that a main trigger for the current discussion about misleading accounting of RRA is a presentation mismatch in financial performance over multiple periods resulting from so-called true-up mechanisms. (For more details we refer to our answer to Questions 5 and 6.) The starting point for any discussion about the desired accounting impact of RRA is the effect on the statement of profit or loss. However, we acknowledge that the conceptual basis for the recognition of income and expenses from RRA should be accounting principles for regulatory assets and liabilities.

We generally agree with the scoping ideas in the DP, which might eventually lead to a narrow-scope standard (For more details regarding the proposed definition we refer to Questions 3 and 4.). However, a narrow scope by itself is not sufficient to argue for a new standard if it tends to be grounded on rules rather than on principles. Therefore, we urge the IASB to carefully consider whether the high hurdles of introducing specific accounting principles for a specific type of business activities are met in the case of RRA.

Although we generally agree with the scoping from a conceptual point of view, as it fits the accounting issue described above, it might cause the following unintended consequences:

a) We support the DP's starting point for scope and definition of the accounting debate on RRA not focussing on a particular industry but rather encompassing a particular type of activities. However, we expect that even an activity-based definition will most likely only cover specific industries on a country-by-country basis depending on the legal environment in each country. For the German environment we provide you with a first indication in our response on Question 2.

b) Since a lot of regulatory frameworks are dynamic and might change over time, the scope of entities covered by the definition might change over the years. A scope-in/scope-out for the industries affected every few years should be avoided.

c) In most cases, RRA as currently defined in the DP do not cover all but only a particular type of transactions of the reporting entity or group when it has an integrated business model. This is a very important factor when considering the cost/benefit constraint of a proposed standard for RRA.

   We urge the IASB to carefully consider the benefit of a new standard on RRA in this context. This becomes even more important if the standard allows and/or requires a specific accounting treatment only – and only for the defined RRA without optionality.

Furthermore, we have identified some operational challenges for integrated businesses. We refer to our answer to Question 8. Not only might these issues cause a significant burden on the preparer's side, but equally they might not necessarily improve the quality of financial information about RRA for users.

Having laid out our views with regard to integrated businesses, we comment on the usefulness of financial information in the reporting entity's individual financial statements and under the assumption that it operates in a pure RRA environment, as follows:

Question a): Preparing financial information about rate-regulated activities

i. Statement(s) of profit or loss and other comprehensive income

Referring to our general remarks above, the ASCG holds the view that RRA effects in the statement of profit or loss are the focus of the discussion. Without pre-empting the conceptual discussion of regulatory assets and liabilities at this stage, we have heard that the presentation of the financial performance of a regulated entity should be based on 'allowable revenue' or 'authorised revenue'. This would reflect the total consideration to which the entity is entitled in exchange for carrying out specified RRA over a period of time.

We share the IASB's argument made in the DP that the most distinguishable feature of defined rate regulation is the entity's right to recover the revenue requirement, using the rate-setting mechanism to adjust for under-billings or over-billings over time. Consequently, the rate-setting mechanism is an important aspect of the effectiveness of the defined rate regulation in ensuring that the entity recovers no more and no less than its revenue requirement.

Due to the fact that current IFRSs do not allow the recognition of regulatory assets and liabilities, most of our constituents agree that the statement of profit and loss of regulated entities does not present their activities fairly. Recognising RRA revenues 'as allowed or authorised' would remedy that issue.

A separate presentation of the revenue requirement within the statement of profit or loss allows for interpreting how RRA affect the performance of the entity (e.g. items 'passing-through' multiple periods).

These effects depend on the useful life of assets and on the compensation schemes or depreciation/amortisation periods set out by the regulatory framework. Effects of regulation that have an impact on regulated entities' results often belong to past periods or – sometimes – to future periods. Some effects are realised over the long term, other over the short term, but they all result from a strict and binding system set out by law or the regulator. A variety of different schemes exists in various regulated systems; therefore, their effects would be most visible if presented as a separate line item in the statement of profit or loss.

ii. Statement of financial position

The existing *Conceptual Framework* defines income and expense as increases/decreases in economic benefits during the accounting period in the form of inflows/outflows or enhancements/depletions of assets or decreases/incurrences of liabilities that result in increases/decreases in equity (other than those relating to contributions from equity participants). Therefore, accounting standards that are developed with the objective of improving the reporting of financial performance of RRA should be based on changes of asset and liabilities.

If RRA true-up mechanisms have a significant impact on the reporting entity, the recognition of a corresponding asset or liability might also be appropriate to ensure a true and fair presentation. A deferral asset or liability arising from RRA claims and obligations from a past event seems useful and important to show how the regulatory framework will affect the overall financial position. This should be limited to the right to recover the revenue requirement, i.e. it should not cover the exclusive right to supply essential goods or services. We refer to our answer to Question 6.

Furthermore, a separate presentation within the statement of financial position of these items allows interpreting how RRA affect the entity in terms of working capital management. Separation of various effects can be important to determine and also to prove cost of capital towards users and the regulator. Additionally, this would allow an entity to present these items in comparison to other elements or would enable users to eliminate the numbers if they are not deemed important.

iii. Statement of cash flows

The ASCG would also support a separate presentation of cash flows from RRA in the Statement of Cash Flows. Several key performance indicators can be derived from cash flow information, and cash flows from RRA, in particular, might be important in the context of a regulated entity.

However, the ASCG acknowledges that separating cash flows from movements in regulatory deferral account balances might not be possible or might not provide useful information as it would only reflect the accrued 'true up'-part in the business model of a regulated entity and would not even represent separate cash flows.

Generally speaking, we believe that it would be quite difficult to designate a specific type of cash flows as "RRA-related". For a regulated entity it might be argued that all operating, investing and financing cash flows relate to rate regulation. On the other hand, for integrated businesses, a separation might provide additional information about regulated and non-regulated businesses, if the regulated part was significant.

We therefore encourage the IASB to further develop presentation principles of rate regulated activities.

iv. Note disclosures

Notes on rate regulation should give additional information about the items accounted for in the primary financial statements, both in the current *and* in future periods. They should, in our view, focus on disclosures of regulatory deferral accounts and the revenue requirement and their respective impact on the financial statements.

For further details we refer to our response to Question 9.

v. Management commentary

Being a National Standard Setter, the ASCG has issued a Standard on Group Management Reports under the German Commercial Code that has to be applied by all entities, regardless of whether they are reporting under German GAAP or IFRSs. That Standard does not include specific reporting requirements for RRA.

Question b): Using financial information about rate-regulated activities

Mapping our comments on the preparer's side, we expect that the same arguments are valid for the usage of financial information about RRA.

We would expect financial information about the regulatory scheme and the revenue requirement, in particular, to be relevant and important for long term investment decisions in a regulated entity, as they are needed to evaluate its sustainable net result for a period. Such information would improve the financial reporting of that entity and the view on the entity and its value drivers.

As far as the case of integrated businesses (which are common in our environment) is concerned, we have mixed views:

On the one hand, one could argue that the relevance of the financial information provided might be the same or even lower under the proposals laid out in the DP. Investors might have difficulties in understanding all the various impacts in a large group of vertically integrated activities where only (minor) parts are subject to rate regulation.

On the other hand, one could argue that because RRA and their impacts might be difficult to analyse in a complex situation with a lot of intra-group transactions, recognition and disclosure of deferral accounts, if included in the consolidated financial statements, might even help investors to understand the overall impact from RRA at a group level (i.e. reflecting only transactions of the group with third parties).

Question 2

Are you familiar with using financial statements that recognise regulatory deferral account balances as regulatory assets or regulatory liabilities, for example, in accordance with US GAAP or other local GAAP or in accordance with IFRS 14? If so, what problems, if any, does the recognition of such balances cause users of financial statements when evaluating investment or lending decisions in rate-regulated entities that recognise such balances compared to:

(a) non-rate-regulated entities; and

(b) rate-regulated entities that do not recognise such balances?

Regulatory frameworks

The Federal Network Agency (Bundesnetzagentur – BNetzA) works as a regulator for Germany's core regulatory frameworks and covers four industry sectors: 'Energy and Gas', 'Tele-communications', 'Postal service' and 'Railway'. In its capacity it is responsible for several regulatory tasks, such as accessibility and quality control as well as consumer protection with regard to the network infrastructure and rate-settings ex ante or rate-adjustments ex post.

The regulatory environment is very different in each of the four sectors, and so are the tasks and the rate-setting frameworks (if any). To facilitate an understanding of how these work, we provide you with some background information about the past and present accounting treatment of regulatory deferral balances (where they occur in these frameworks) under German GAAP that we collected from our constituency:

i. Energy and Gas

The Energy Act assigned the task of regulating Germany's electricity and gas markets to the BNetzA. The purpose of regulation is to establish fair and effective competition in the supply of electricity and gas. The responsibilities of the BNetzA therefore include ensuring non-discriminatory third-party access to networks and policing the use-of-system charges levied by market players.

German electricity network operators are regulated under an incentive-based regulation scheme since 2009. This scheme provides a so called revenue cap regulation over a regulation period of five years. The revenue cap determines the allowed revenue of the network operator for one regulation period. It consists of imputed cost positions for influenceable and non-influenceable cost and several positions of cost compensation. In addition, the revenue-cap covers the result of true-ups for past periods. Under certain criteria the network operator is allowed to adjust the revenue cap for specific positions (incurred cost) to allow reasonable cost compensation for new or changed elements in future periods. Adjustments for inflation as well as due to the result of efficiency benchmarks are to be initiated by the regulator. Besides, prices for the use of the electricity networks (determined via the revenue-cap of the year) different types of pass through mechanisms – operated by the network operators – are also under the scrutiny of the BNetzA. Variances between the allowable revenue and actual amounts charged for each calendar year will be monitored and will have to be paid back to customers or lead to an increase of future tariffs. Such true-up mechanisms are spread over 1 to 5 years depending on their origin and volume compared to the overall allowable revenue of the network operator.

The practical experience of our constituency with regulatory deferral account balances from net operations is basically limited to the provisions of German GAAP (Commercial Code and/or tax laws). There is a majority view that German GAAP does not allow for the accounting of assets for such balances. In contrast, liabilities are recognised as a provision for uncertain obligations from a past event or onerous contracts.

ii. Telecommunications

The central task of the regulation by the BNetzA in the area of telecommunication is to keep an eye on the dominant provider's market power and to help new competitors enjoying the same opportunities. Hence, the approach goes beyond a mere "ex post" control of anti-competitive practices. The regulatory tasks are so specialised that they cannot be resolved with the tools of general competition law alone. That is why sector-specific regulation is necessary, at least until full competition has been established in the telecommunication market.

The telecommunication industry in Germany is largely subject to national and European regulation, which is associated with extensive powers to intervene in the product design and pricing. The regulation covers mobile and fixed-network businesses. The involvement of the regulator focuses primarily on the wholesale services – in particular broadband wholesale services and investments in new networks and infrastructure as well as the corresponding rates, along with the allocation of mobile spectrum.

The rate regulation in the telecommunications industry in Germany covers the rates for unbundled local loop lines (ULLs) including the shorter connection from the cable distribution box (sub-loop unbundling) as well as the mobile and fixed-network termination rates. In this regard, all rates are set prospectively by the BNetzA and are by nature post-paid monthly charges without any possibility of a true-up mechanism, since every minute used will be charged with the regulated price per minute.

The only exception might be rate measures for bitstream products which are subject to "ex-post" price regulation by the BNetzA, to which they must be announced before they take effect. A bitstream access (BSA) is a wholesale service used by alternative telephone companies to provide broadband lines. BSA rates are based on an ex-ante calculation for certain traffic on broadband lines which are covered by a post-paid flat fee. In the event that the alternative telephone company has more traffic on the broadband line the excess traffic will be charged to the alternative telephone company. While there is a rate-setting mechanism to adjust for under-billings in the event of more traffic than the flat tariff covers there is no similar mechanism for any over-billings due to the flat fee. Even if the customers of the alternative telephone companies do not use the broadband lines the monthly flat fee has to be paid over the contract term. Hence, there seems to be no regulation mechanism to ensure that a company recovers only the amount of its revenue requirement and therefore there is no true-up mechanism in accordance with paragraph 4.72 of the DP.

iii. Postal service

Since 2008, the German mail market is broadly liberalised. Nevertheless, postal services relating to single mail items up to one kilo are subject to licences. In case the licence holder is a market-dominating company, the BNetzA has to approve the prices for these services. Generally, the approval is based on a price cap regulation. Relevant services of the company are grouped in a basket. For each service a maximum price limit has to be set up taking into account the inflation rate and an estimated productivity progress rate of the company concerned.

So far, we have not identified significant accounting issues in this industry sector under German GAAP regarding RRA, as it is basically run in the form of a market regulation without cost-related multi-period true-up mechanisms.

iv. Railway

The BNetzA supervises non-discriminatory access to rail infrastructure and non-discriminatory charges for its use. Another of its tasks is checking compliance with statutory pricing principles and price levels. It also monitors the market. The BNetzA covers the following areas: Legal policy issues, economic policy issues, market monitoring and statistics as well as operational tasks of rail regulation like access to rail infrastructure and services, access to service facilities and services and charges for networks, service facilities and services.

We did not identify specific accounting issues or treatments in this industry sector under German GAAP regarding RRA as the pricing mechanisms do not foresee multi-period true-up adjustments for past events.

Investment and lending decisions

Regarding the impact on users of financial statements when evaluating investment or lending decisions, it is worth mentioning that dividend calculations are based on German GAAP financial statements in accordance with company law. However, a number of listed entities base their dividend policy on group financial statements prepared under IFRSs.

There is clear evidence that in case of a business acquisition of a regulated entity, the value of regulatory deferral accounts is taken into consideration when evaluating the entity value at the closing date. These accounts reflect an economic advantage or disadvantage for the future, as the entity has the right or obligation with regard to an economic resource (future rates).

Question 3

Do you agree that, to progress this project, the IASB should focus on a defined type of rate regulation (see Section 4) in order to provide a common starting point for a more focused discussion about whether rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements might need to be developed (see paragraphs 3.6–3.7)? If not, how do you suggest that the IASB should address the diversity in the types of rate regulation summarised in Section 3?

We agree with this proposal. In particular, we agree with the IASB seeking to determine whether rate regulation creates distinguishable rights and obligations that support recognition of ‘regulatory assets’ or ‘regulatory liabilities’ in addition to the assets and liabilities already recognised in accordance with IFRS for non-rate-regulated activities.

Question 4

Paragraph 2.11 notes that the IASB has not received requests for it to develop special accounting requirements for the form of limited or 'market' rate regulation that is used to supplement the inefficient competitive forces in the market (see paragraphs 3.30–3.33).

(a) Do you agree that this type of rate regulation does not create a significantly different economic environment and, therefore, does not require any specific accounting requirements to be developed? If not, why not?

(b) If you agree that this type of rate regulation does not require any specific accounting requirements, do you think that the IASB should, alternatively, consider developing specific disclosure requirements? If so, what would you propose and why?

The ASCG has not received requests for developing specific accounting requirements for pure incentive-based schemes, such as market regulation. We share the IASB's view that this type of rate regulation does not create a significantly different economic environment and, therefore, does not require any specific accounting requirements to be developed.

For the same reasons, we do not support specific disclosure requirements for market regulation. However, a disclosure might provide useful information in the case where RRA transactions are made on terms not equivalent to those that prevail in arm's length transactions (if such terms can be substantiated) or that are not equivalent to those of other regulated entities in the same regulatory framework.

Question 5

Paragraphs 4.4–4.6 summarise the key features of defined rate regulation. These features have been the focus of the IASB's exploration of whether defined rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements might be developed in order to provide relevant information to users of general purpose financial statements.

(a) Do you think that the description of defined rate regulation captures an appropriate population of rate-regulatory schemes within its scope? If so, why? If not, why not?

(b) Do you think that any of the features described should be modified in order to include or exclude particular types of rate-regulatory schemes or rate-regulated activities included within the scope of defined rate regulation? Please specify and give reasons to support any modifications to the features that you suggest, with particular reference to why the features may or may not give rise to circumstances that result in particular information needs for users of the financial statements.

(c) Are there any additional features that you think should be included to establish the scope of defined rate regulation or would you omit any of the features described? Please specify and give reasons to support any features that you would add or omit.

Considering the conceptual background as described in Section 3, the ASCG understands the basic reasoning for the proposed definition in paragraphs 4.4-4.6 of the DP. However, we noticed that some of parts of that definition do not necessarily trigger accounting consequences. Instead, they are of a more descriptive nature, elaborating on the motivations or reasons for the existence of a regulatory environment.

This particularly applies to the following three proposed criteria of a regulatory pricing (i.e. rate-setting) framework of defined rate regulation:

- applying in situations in which *customers have little or no choice but to purchase* the goods or services from the rate-regulated entity (i.e. no effective competition to supply; and the rate-regulated goods or services are essential to customers).
- establishing parameters to *maintain the availability and quality* of the supply of the rate-regulated goods or services and other rate-regulated activities of the entity.
- establishing parameters for rates that *provide regulatory protections* (i.e. support greater stability of prices for customers; and support the financial viability of the rate-regulated entity.)

As we see it, these criteria were added to the definition to aim at a very high certainty of the future recoverability of the effect from true-up mechanisms. In our view, this recoverability threshold should not be part of the definition, but should instead be discussed as part of recognition and measurement of a regulatory asset or liability (like indicators for a recognition or measurement threshold).

The core criterion is the existence of *rights and obligations that are enforceable* on the rate-regulated entity and on the rate regulator. Regarding the criterion of "enforceability" we would like to raise the point that it might be necessary to distinguish between

a) rights and obligations that are enforceable (usually long-term rights and obligations over a multi-year regulation period, e.g. the exclusive right to receive a regulated rate for the supply of essential goods or services and the obligations to achieve the defined minimum service level); and

b) the right or obligation to recover the revenue requirement, which – in isolation – might not be enforceable as it is linked to the ongoing rendering of services in the future.

We would like the definition to refer to the right or obligation per b), in a sense that the enforceable rights per a) *"ensure"* that the entity recovers no more or less than its revenue requirement. Referring to our answer to Question 6, we think that this type of right (which is the right to recover the revenue requirement as proposed in paragraph 4.72 of the DP) is the basis for the current discussion about accounting mismatches and for the lack in faithful representation of the financial performance of a rate-regulated entity. We do not see a general information mismatch for all rate-regulated activities. This is why we would like the definition and the scope of the new standard to focus on this specific item (true-up mechanism).

We urge the IASB to clearly distinguish between "enforceability" and "economic compulsion"; the latter should not be form part of the basis for RRA accounting principles.

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Question 6

Paragraphs 4.62–4.72 contain an analysis of the rights and obligations that arise from the features of defined rate regulation.

(a) Are there any additional rights or obligations that you think the IASB should consider? Please specify and give reasons.

(b) Do you think that the IASB should develop specific accounting guidance or requirements to account for the combination of rights and obligations described? Why or why not?

The ASCG did not identify any additional rights or obligations that the IASB should consider.

Regarding the 'Exclusive right to supply essential goods or services', we share the IASB's evaluation that the essential nature of the rate-regulated goods or services and the lack of effective competition do not appear to create distinguishable rights or obligations for which specific accounting guidance is needed.

Similarly, regarding the ‘Obligations to achieve the defined minimum service level’ it seems reasonable to conclude that such obligations do not create a special environment for which specific accounting requirements need to be developed for rate-regulated entities. This is because these regulatory obligations can be found in many competitive environments and, therefore, are not exclusive to entities that are subject to defined rate regulation.

As envisaged in our response to Question 5, we would like the IASB to focus its further work on the ‘Right to recover the revenue requirement’. We consider this criterion being the most distinguishable feature of defined rate regulation, using the rate-setting mechanism to adjust for under-billings or over-billings over time: This right ensures that the entity (and its capital providers) can rely on the rate regulation to recover its reasonable costs over the operational life of the assets that are used in providing the rate-regulated goods or services. However, defined rate regulation also ensures that the entity has a right to recover only the amount of its revenue requirement. Defined rate regulation seeks to do this by prohibiting the entity from retaining any excess amounts billed to customers.

Question 7

Section 5 outlines a number of possible approaches that the IASB could consider developing further, depending on the feedback received from this Discussion Paper. It highlights some advantages and disadvantages of each approach.

(a) Which approach, if any, do you think would best portray the financial effects of defined rate regulation in IFRS financial statements and is most likely to provide the information that investors and lenders consider is most relevant to help them make their investing and lending decisions? Please give reasons for your answer?

(b) Is there any other approach that the IASB should consider? If so, please specify and explain how such an approach could provide investors and lenders with relevant information about the financial effects of rate regulation.

(c) Are there any additional advantages or disadvantages that the IASB should consider before it decides whether to develop any of these approaches further? If so, please describe them.

If commenting on the asset/liability approach, please specify, if it is relevant, whether your comments reflect the existing definitions of an asset and a liability in the Conceptual Framework or the proposed definitions suggested in the Conceptual Framework Discussion Paper, published in July 2013.

Question a): Approach which best portrays and is most relevant for investors/lenders

i. Conceptual Framework and the asset and liability debate

Noting the intense discussions and strong concerns within our constituency on whether the regulatory account balances meet the definition of an asset or a liability under the existing framework, we believe that the existing framework does not sufficiently support the recognition of these items. In our view, the Conceptual Framework should provide a clear basis for the assessment of whether regulatory deferral accounts meet the definition of assets and liabilities.

Notwithstanding any clarification or changes to the Conceptual Framework, a specific accounting standard might be required to address the complexity of the issue with sufficient clarity.

ii. The specific approaches suggested

'Recognising the package of rights and obligations established by the regulatory agreement as an intangible asset' (e.g. a licence) does not, in our view, portray the financial effects of rate regulation well. We agree with the counterarguments to this approach presented in the DP. The potential complexity and associated costs of applying such modified requirements to the regulatory licence, or components of it, raise questions about whether the benefits of such an approach would outweigh the costs.

Also, we do not believe that *'Reporting using regulatory accounting requirements'* best portrays the financial effects of rate regulation. Among other reasons presented in the DP, the different accounting regimes may be incomplete, substantially different from IFRS and incompatible or contradictory which will also result in less comparability of financial statements of entities.

Referring to our comments on a reporting entity with integrated businesses, it is likely that these larger groups have rate-regulated entities with activities in different locations/jurisdictions that are subject to defined rate regulation. The regulatory accounting requirements for similar items may differ, depending on the details of the rate regulation in each location.

In addition, the argument that preparing financial statements on two bases is onerous equally applies to many entities if the reporting requirements required for tax or other regulatory purposes differ from general purpose financial statements. The regulatory accounting requirements for similar items may differ, depending on the details of the rate regulation, in each location.

Of the alternative approaches presented in the discussion paper, we favour *'Developing specific IFRS requirements to defer/accelerate the recognition of costs and/or revenue'* and encourage the IASB to further develop this approach.

We can see the advantages of developing specific IFRS requirements for reporting the financial effects of defined rate regulation, instead of relying on the regulatory accounting requirements. Retaining general IFRS requirements as the starting point, and using the principles of IFRS to identify the extent to which the general requirements of IFRS are modified to reflect the consequences of rate regulation, would help in maintaining the quality, transparency and comparability of the information provided in general purpose financial statements.

However, we acknowledge that specific IFRS requirements would add complexity to dealing with the interactions between the regulatory requirements and the general IFRS requirements (e.g. adjustments to the revenue requirement related to the acquisition or construction of rate-regulated tangible assets), but this would not outweigh the benefits.

Furthermore, we do not believe that *'Prohibiting the recognition of regulatory deferral accounts'* best portrays the financial effects. In our view, it is not appropriate to focus on disclosures only. We do not share the arguments in the DP that suggest that the IASB should not develop any specific accounting requirements for defined rate-regulated activities.

iii. Other approaches

Considering the discussion in the DP on the interaction with IFRS 15, we see some merits in the idea that rate regulation may be considered to be an implied or quasi-contract between the rate-regulated entity and the collective customers ('customer base').

We would therefore encourage the IASB to explore further the core elements of the revenue recognition approach under IFRS 15 in a RRA context, which are the definition of a customer base, the quasi-contract, the regulated performance obligation and its way of satisfying as well as the transaction price.

If the IASB decides to develop specific IFRS requirements involving the deferral or acceleration of revenue, it should consider whether and, if so, how the principles of IFRS 15 could be adapted to form the basis of a tailored revenue recognition model for rate-regulated activities. In this context we would like to specifically mention the exception in paragraph B63 of IFRS 15 which, in contrast to the general requirements for variable considerations in paragraphs 56–59, allows for the recognition of revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when certain events occur. We would like the IASB to consider whether this linkage of a past and future event is consistent with the proposed accounting principles for deferrals from RRA.

Furthermore, we wonder whether there are some similarities between timing concepts for deferred taxes and the accounting issues from revenue requirements in relation to RRA. These timing concepts in various accounting jurisdictions basically aim at reflecting the effects from income tax as expenses from a 'tax performance' perspective (nominal tax rate vs. effective tax rate) and ask for corresponding deferral adjustments (DTA/DTL), as well as disclosures (tax reconciliation).

Although we acknowledge that IAS 12 is based on a temporary concept where the similarities might be less straight forward, we think it might be worth considering the principles of deferred taxes in the further development of a standard on rate regulation.

iv. Additional advantages or disadvantages

We did not identify additional advantages or disadvantages. However, we would like to reiterate that the evaluation above is based on a reporting entity with all or at least a significant part of its business within the scope of the DP. E.g., for an entity with integrated businesses a disclosure-only approach might deliver appropriate information for materiality reasons. Also, for these entities it could be argued that the cost of a specifically developed IFRS requirement outweighs the benefits.

Question 8

Does your organisation carry out activities that are subject to defined rate regulation? If so, what operational issues should the IASB consider if it decides to develop any specific accounting guidance or requirements?

The ASCG does not carry out activities subject to rate regulation. From our constituency we heard about specific operational issues the IASB should consider if it decides to develop any specific accounting guidance or requirements. Those relate to:

i. Economic entity approach in a group with an integrated business model

The DP is silent on any consolidation procedures. However, we would like the IASB to consider the impact of 'group-internal' regulatory assets and liabilities in a vertically integrated business. Under an economic entity approach one would expect any intra-group RRA transactions to be eliminated on group level.

Example: entities in the German electricity sector are most likely affected in business models as transmission or distribution service operators (TSO and DSO). However, a large group of a vertically integrated electricity provider (= reporting entity) will most likely also cover the rest of the value chain, such as electricity production, storage, sales and trading. (RRA with deferral balances would therefore only cover a minor part of their overall activities, as all these other transactions in Germany are most likely not covered by the proposed definition as no true-up mechanisms exist.)

Questions arise and further guidance might be needed in cases where the RRA network operation is (partly) rendered as internal service for other business units of a group. We would like to illustrate this with the following example:

Let us assume a DSO that renders 90% of its rate regulated network operation services in a certain urban area to the business unit sales of the group that sells electricity to outside customers in that area. The remaining 10% are the same network services provided to third-party electricity providers in the area like public utility companies and numerous electricity traders.

We have heard from our constituency that handling the DSO's deferral account is not clear in this case. Assuming that the regulatory balance would give rise to the recognition of an asset under the proposals in the DP the following issues need to be considered:

(a) While there is a 100% regulatory asset in the DSO's separate financial statements, this might be significantly diluted from a group perspective (to 10% in this example). We question whether the complexity of recognising the asset and then considering all future intra-group services justifies the outcome which might be some sort of 'proportionate asset'. Furthermore, judgement will be needed in cases where the ratio of internal vs. external RRA revenue changes over the years. E.g., the assumed proportion of 90% vs. 10% might change over the years of the regulation period until the true-up will affect the rates.

(b) Measurement or even the existence of a regulatory asset from a group perspective also depends on the pricing arrangements and risk sharing between the DSO and the sales unit of the group. For example:

 (i) Case 1 – Fixed electricity sales prices: The sales unit gets fixed or regulated market prices for the integrated services including the DSO services. It does not have the right to adjust its electricity sales prices based on changes in the DSO regulated rates. Therefore, the group has to cover the DSO market risk as far as internal services are provided (i.e. supply of energy as one integrated service). This might give rise to a 10% recognition of a regulatory asset based on the revenue requirement.

 (ii) Case 2 – Pass-through DSO services arrangement: Changes in rates of RRA can be charged from the sales unit to external customers when the DSO services are internally purchased and externally sold as part of integrated services. As there is no market risk from RRA this might give rise to a 100% recognition of a regulatory asset based on the revenue requirement. (i.e., network operation and supply of energy as two separately charged services).

ii. Segment reporting in an integrated business model

The DP is silent on segment reporting. Further guidance might be needed on how to deal with RRA within segment reporting, specifically as regards intra-group RRA transactions between regulated and non-regulated segments in integrated businesses and the impacts on impairment testing as well as the reporting of segment revenue or segment assets and liabilities (reconciliation between internal non-GAAP and IFRS measures).

iii. Interim or inter-period reporting

The DP is silent on interim reporting. Interim and even year-end reporting might require some guidance on the basis for estimates when recognising and measuring regulatory deferral balances. In our environment, we found many regulatory regimes providing only annual or even multi-annual revenue requirements.

Question 9

If, after considering the feedback from this Discussion Paper and the Conceptual Framework project, the IASB decides to prohibit the recognition of regulatory deferral account balances in IFRS financial statements, do you think that the IASB should consider developing specific disclosure-only requirements? If not, why not? If so, please specify what type of information you think would be relevant to investors and lenders in making their investing or lending decisions and why.

As mentioned earlier in this comment letter, notes on rate regulation should give additional information how RRA affect current and future financial statements with the objective of delivering more details about the financial effects from true-ups in the reporting period and giving additional forecast information about future financial effects caused by the regulatory scheme.

However, if the IASB decides to prohibit the recognition of regulatory deferral account balances, disclosures might be helpful to understand

(a) the extent to which the profit or loss in the current period was affected by regulatory deferrals from earlier periods; and

(b) the impact of regulatory deferrals of the current period on future periods' results.

Therefore, it might be reasonable to disclose the development and a maturity analysis of the aggregate amount of regulatory account balances (even if not recognised as an asset or liability) in the current and future periods.

However, the complexity of regulatory regimes requires carefully balancing the disclosure needs with the quality and reliability of information provided. We refer to our comments on estimates and operational issues above.

Again, disclosure requirements might be assessed as being more valuable for a pure regulated entity compared to a group with integrated businesses.

Question 10

Sections 2 and 6 discuss some of the information needs of users of general purpose financial statements. The IASB will seek to balance the needs of users of financial statements for information about the financial effects of rate regulation on an entity's operations with concerns about obscuring the understandability of financial statements and the high preparation costs that can result from lengthy disclosures (see paragraph 2.27).

(a) If the IASB decides to develop specific accounting requirements for all entities that are subject to defined rate regulation, to what extent do you think the requirements of IFRS 14 meet the information needs of investors and lenders? Is there any additional information that you think should be required? If so, please specify and explain how investors or lenders are likely to use that information.

(b) Do you think that any of the disclosure requirements of IFRS 14 could be omitted or modified in order to reduce the cost of compliance with the requirements, without omitting information that helps users of financial statements to make informed investing or lending decisions? If so, please specify and explain the reasons for your answer.

The ASCG very much appreciates that the IASB seeks to balance the needs of users of financial statements for information about the financial effects of rate regulation on an entity's operations with concerns about obscuring the understandability of financial statements and the high preparation costs that can result from voluminous disclosures.

So far we have no practical experience with IFRS 14, due to IFRS 14 not being endorsed in the EU. Generally speaking, we do not think that financial statements based on the exceptions and exemptions for first-time adopters meet the information needs of investors and lenders for more than a transition period. We would therefore maintain our recommendation to develop specific accounting requirements as a long-term solution. The requirements of IFRS 14 might be a starting point for the evaluation of adequate disclosures.

Question 11

IFRS 14 requires any regulatory deferral account balances that have been recognised to be presented separately from the assets and liabilities recognised in the statement of financial position in accordance with other Standards. Similarly, the net movements in regulatory deferral account balances are required to be presented separately from the items of income and expense recognised in the statement(s) of profit or loss and other comprehensive income.

If the IASB develops specific accounting requirements that would apply to both existing IFRS preparers and first-time adopters of IFRS, and those requirements resulted in the recognition of regulatory balances in the statement of financial position, what advantages or disadvantages do you envisage if the separate presentation required by IFRS 14 was to be applied?

Referring to our response to Question 1, we would support presenting regulatory deferral account balances and their movements as separate line items in the statement of financial position as well as in the statement of profit or loss as this presentation is necessary to get information about the financial effects of rate regulation on the face of the primary financial statements.

However, we are not convinced that a regulated entity should be required to present any regulatory deferral account balances that have been recognised separately from the assets and liabilities recognised in the statement of financial position in accordance with other standards. This is because – in contrast to the principles in IFRS 14 – these regulatory assets and liabilities would be based on recognition and measurement principles of IFRSs and, therefore, do not need special presentation. For the same reason we have doubts whether the net movements in regulatory deferral account balances should be presented separately from the items of income and expense recognised in the statement(s) of profit or loss and other comprehensive income.

Question 12

Section 4 describes the distinguishing features of defined rate regulation. This description is intended to provide a common starting point for a more focused discussion about whether this type of rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements should be developed.

Paragraph 4.73 suggests that the existence of a rate regulator whose role and authority is established in legislation or other formal regulations is an important feature of defined rate regulation. Do you think that this is a necessary condition in order to create enforceable rights or obligations, or do you think that co-operatives or similar entities, which operate under self-imposed rate regulation with the same features as defined rate regulation (see paragraphs 7.6–7.9), should also be included within defined rate regulation? If not, why not? If so, do you think that such co-operatives should be included within the scope of defined rate regulation only if they are subject to formal oversight from a government department or other authorised body?

In our response to Question 5 on the definition of rate regulation, we did not consider the existence of a regulator in our proposed definition. In our view, the existence of a rate regulator whose role and authority is established by legislation or other formal regulations is an important indicator to consider when analysing what rights and obligations established by the rate regulation are enforceable. However, it is not a necessary feature. Putting it the other way round: The non-existence of a rate regulator is not relevant as long as there exist substantive rights or obligations. This is the case when the regulatory rate-setting framework is based on legal grounds (i.e. enforceable by law).

So far, we have limited experience with the accounting of cooperatives under IFRS. However, we hold the view that the above principles should apply in a similar way for all entities. As long as there are substantive rights and obligations arising from a revenue requirement (‘true-up mechanism’) the accounting consequences should be the same when there are enforceable rights (like an exclusive right to receive a regulated rate for the supply of goods or services) that *“ensure”* that the entity recovers no more or less than its revenue requirement.

In case of a cooperation, enforceability could be based on long-term contracts of the cooperation (i.e. again enforceable by law). On the other hand, it should be common sense that rates that can be changed or reversed by the management of the cooperation on a short-term basis from period to period in its own judgement do not fulfill the enforceability criteria.

Question 13

Paragraphs 7.11–7.22 highlight some of the issues that the IASB may consider if it continues to progress this project.

Do you have any comments or suggestions on these or any other issues that may or may not have been raised in this Discussion Paper that you think the IASB should consider if it decides to develop proposals for any specific accounting requirements for rate-regulated activities?

The ASCG acknowledges the IASB's deliberations on the interaction of accounting principles for RRA with IFRIC 12, IAS 20 and IFRS 3. The IASB may indeed need to consider if, as a result of the feedback from the DP, it decides to develop proposals for amending these IFRSs.

We understand that it is premature to present an analysis of the issues or suggestions for their resolution at this time. However, we think that the list of interaction needs to be elaborated. We also see close interactions with:

a) IFRS 8 – *Operating segments*, e.g. the disclosure requirements in paragraph 27, where an entity shall provide an explanation of the measurements of segment profit or loss, segment assets and segment liabilities for each reportable segment. Further guidance might be needed on which basis intra-group RRA in an integrated business model shall be disclosed and reconciled (including the nature of any differences between the measurement applied in the reportable segments and at group level).

b) IAS 36 - *Impairment of Assets*, e.g. to clarify which elements shall be reflected in the calculation of an RRA asset's value according to paragraph 30, what is the basis for estimates of future cash flows according to paragraph 33 and the composition of estimates of future cash flows according to paragraph 39. This is of particular interest when the regulated revenues cover or reimburse certain investing activities of the regulated entity. Similar questions might arise when the carrying amount of a cash-generating unit with RRA needs to be determined according to paragraph 75.

c) IFRS 5 – *Non-current Assets Held for Sale and Discontinued Operations*, e.g. to explain when regulatory assets and liabilities form part of a disposal group as defined in Appendix A and when they are classified as non-current assets (or disposal groups) as held for sale according to paragraph 6. Furthermore, it needs to be clarified how an entity shall measure a non-current RRA asset (or disposal group containing such assets) classified as held for sale (i.e. how to apply fair value less costs to sell of RRA deferral balances).

d) IAS 7 – *Statement of Cash Flows*, e.g. how to present a statement of cash flows for a RRA business model. Further guidance or examples might be needed on how the statement of cash flows shall report cash flows during the period classified as operating, investing and financing activities.

Finally, we refer to our answer to Questions 8. Some of the operational issues described there are also related to the interaction of RRA with other standards and should be considered for amendments or guidance.